Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
1993 Annual Access Tariffs	)	CC Docket No. 93-193
1994 Annual Access Tariffs	)	CC Docket No. 94-65

COMMENTS OF SBC COMMUNICATIONS, INC.

SBC Communications Inc. ("SBC") hereby submits these comments in response to the Public Notice issued concerning the foregoing dockets.[1] Therein, the Wireline Competition Bureau ("Bureau") asks interested parties to refresh the record on the appropriate treatment of sharing and low-end adjustments in the 1993 and 1994 access tariffs. As SBC demonstrates below, the Commission did not revise its rules to require price cap LECs to "add back" sharing and low-end adjustments when calculating their rates of return and subsequent sharing obligations until 1995. Consequently, price cap LECs that did not perform the add-back procedure in computing their 1993 and 1994 sharing obligations did not act in an unjust or unreasonable manner and any finding to the contrary would constitute unlawful retroactive application of a substantive rule change.

I. BACKGROUND

In 1990, the FCC replaced its rate-of-return regulation for the BOCs and other large LECs with price-cap regulation. Price-cap regulation is an incentive-based form of regulation that encourages productivity growth by permitting carriers that increase their productivity to earn a higher rate of return, while allowing interstate access customers to benefit in the productivity

[1] *Further Comment Requested on the Appropriate Treatment of Sharing and Low-end Adjustments Made By Price Cap Local Exchange Carriers in Filing 1993 and 1994 Interstate Access Tariffs*, Public Notice, DA 03-1101, CC Docket Nos. 93-193, 94-65 (April 7, 2003) (Public Notice).

growth through reduced rates.[2] Under the original price cap plan, a carrier earning a rate of return over a specified percentage, 12.25 percent, would be required to share half, and in some instances 100%, of their earnings above that level with their interstate access customers through lower rates in the following year (i.e. "sharing"). Similarly, carriers that earned less than a specified rate of return, 10.25 percent, were permitted to adjust their rates upward in the next year to achieve a 10.25 percent earning in the year they under-earned (i.e. "low-end adjustment").[3] The Commission determined that these back-stop mechanisms were necessary to ensure that carriers' rates under price-cap regulation were not unreasonably high or low due to varying economic and operational circumstances faced by LECs.[4]

The LECs' rates under price caps took effect on January 1, 1991. LECs that over-earned or under-earned in 1991 were required to make their sharing or low-end adjustments during the 1992 annual access tariff filings. Specifically, the Bureau permitted NYNEX and SNET to make low-end adjustments to account for under-earnings in 1991. When these carriers calculated their 1992 earnings and rates of return as part of their 1993 annual access tariff filings, they excluded the revenues they received in 1992 due to the low-end adjustment. This reduced their overall 1992 earnings and rates of return and their subsequent sharing obligations. AT&T challenged these tariffs, arguing that SNET and NYNEX should not have excluded revenues obtained from the low-end adjustment from their 1992 earnings.

The Commission concluded that the issue of how price cap LECs should compute their rates of return in light of their sharing and low-end adjustments was the subject of a recently

[2] Public Notice at 2-3.

[3] *Id.*

[4] *Id.*

issued NPRM, wherein the Commission tentatively concluded that price cap LECs should follow the "add-back" method governing rate-of-return carriers.[5] Under this "add-back" method, rate of return LECs were not only required to refund any earnings over the maximum allowable rate of return to customers through reduced rates in the subsequent tariff period, but had to "add back" the amount of the refund for the prior over-earnings into the total earnings used to calculate the rate of return for that subsequent period. Because the *Add-Back NPRM* was still pending, the Commission suspended the affected 1993 annual access tariff filings for one day, imposed an accounting order, and initiated an investigation pertaining to all LECs that had a sharing or low-end adjustment for 1992.[6] Likewise, in 1994, the Commission suspended the annual access tariffs of any LECs that had a sharing or low-end adjustment for 1993 and incorporated the 1994 annual access tariffs into the 1993 investigation.

The Commission in 1995 issued an order revising its price-cap rules to require price cap LECs to "add back" over-earnings or under-earnings in a prior period to the total earnings received in a subsequent period.[7] The Commission, however, never resolved the appropriate treatment of sharing and low-end adjustments in the 1993 and 1994 tariffs.

Almost nine years later, on April 7, 2003, the Bureau issued a Public Notice asking parties to refresh the record on this issue. Specifically, the Bureau seeks comment on the following: (1) How should price cap LECs have reflected amounts from prior year sharing or

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[5] *Price-Cap Regulation of Local Exchange Carriers, Rate-of-Return Sharing and Lower Formula Adjustment*, Notice of Proposed Rulemaking, 8 FCC Rcd 4415 (1993) (*Add-Back NPRM*).

[6] *1993 Annual Access Tariff Filings*, CC Docket No. 93-193, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, 8 FCC Rcd 4960 (Com. Car. Bur. 1993) (*Designation Order*).

[7] *Price-Cap Regulation of Local Exchange Carriers, Rate-of-Return Sharing and Lower Formula Adjustment*, Report and Order, 10 FCC Rcd 5656 (1995). Note, under the add-back rule, carriers that made a low-end adjustment due to under-earnings in a prior period would exclude the earnings they received in light of the adjustment from the total earnings obtained in the subsequent period.

low-end adjustments to price cap indices for the following year; and (2) Would application of the add-back rule to the 1993 and 1994 access tariffs constitute unlawful retroactive application of a substantive rule change?[8]

II. ARGUMENT

Before addressing the specific questions raised in the Public Notice, as a threshold matter, SBC finds it untenable that the Bureau would now revive this proceeding almost a *decade* after initiation. Not only is there no legal or policy justification for doing so — particularly given that there were no rules in place in 1993 or 1994 requiring price-cap carriers to follow the add-back rules governing rate-of-return carriers — but such action flies in the face of the limitations period imposed under Section 204(a)(2)(B).[9] That subsection requires the Commission to issue an order concluding a Section 204 investigation *not later than 12 months* after enactment of the 1996 Act. Here, the statutory deadline for completion of this proceeding has already been exceeded by *six* years. To resume this investigation and possibly require LECs to issue refunds for actions taken a decade ago — actions not prohibited under the Commission's then-existing rules — would render Section 204 a nullity and in effect give the FCC carte blanche authority to initiate and terminate tariff investigations at will — a result clearly contrary to Section 204(a)(2)(B). In any event, refunds would be inappropriate here because any price cap LEC's failure to add back prior to 1995 was not an unjust or unreasonable practice under the Act or the FCC's rules. Below SBC addresses the specific issues raised by the Public Notice.

1. How should price cap LECs have reflected amounts from prior year sharing or low-end adjustments to price cap indices for the following year?

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[8] Public Notice at 5.

[9] 47 U.S.C. §204(a)(2)(B).

Under the price-cap rules in effect during the 1993 and 1994 timeframe, there were no rules requiring price-cap carriers to follow the add-back rules governing rate-of-return carriers. This fact is confirmed by the *Add-Back NPRM*.[10] Therein, the Commission said,

> [W]e recognize that this [add-back] issue was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules. "Add back" also poses implementation issues that it may be useful to air and resolve now that the first tariffs raising this issue are before us. Accordingly, we are establishing this docket to seek comment on the tentative conclusion discussed below, and on proposed rule changes, to incorporate "add back" clearly into the LEC price-cap rules.[11]

Given the foregoing admission that the initial price-cap rules did not require LECs to add back, the appropriate inquiry is whether, in the absence of a clear requirement, it was an unjust and unreasonable practice for price cap LECs not to add back.

Certainly, the Commission would be correct to conclude that those price cap LECs that followed the add-back rules to compute their 1992 earnings and rates of return and subsequent sharing obligations acted in a manner consistent with the FCC's rules. While add back was not required, add back was a reasonable method for price-cap carriers to use to calculate their 1993 sharing obligations. Indeed, in proposing to revise its rules to mandate add back, the Commission implicitly found that price cap LECs that followed the add-back rules acted in a reasonable manner.[12] That said, given that add back was not required for price cap LECs prior to 1995, the Commission cannot conclude that a carrier's failure to add back in computing its 1992 rate of return and subsequent sharing obligation was unreasonable.

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[10] *Add-Back NPRM* at 4415.

[11] *Id.*

[12] *Id.* ¶

As the prior record in the proceeding reflects, there were numerous reasons why price cap LECs may have reasonably concluded that add back was not necessary under price-cap regulation. First and foremost, the Commission expressly recognized in its *Add-Back NPRM* that under its then-existing rules an argument could be made that price cap LECs should base their sharing obligations on actual earnings. Specifically, the Commission stated, "it might be argued that the rate-of-return methodology used to define sharing obligations and lower formula adjustments should be based upon the returns achieved under the rates actually charged during the base year."[13] Based on this recognition, the Commission sought comment on its tentative conclusion that add back should be required for price cap LECs *and* solicited comment on other mechanisms to deal with its concerns regarding add back. Thus, it was entirely reasonable for carriers to conclude that exclusion of add back from their earnings, until the Commission conclusively determined otherwise, was reasonable.

Second, there are material differences between rate-of-return regulation and price-cap regulation that could have lead some price caps LECs to conclude that add back was not an integral part of price-cap regulation. For example, under rate-of-return regulation, LECs that over-earned were required to issue a refund because, as the Commission concluded, over-earnings were indicative of unlawful rates.[14] This was not the case under initial price-cap regulation. Over-earnings did not infer an illegal rate structure. Sharing was required only as a means for carriers to share their productivity achievements over certain thresholds with their customers. Thus, while refunds clearly constituted a penalty for past performance, sharing was merely a prospective adjustment of the LEC's productivity target as a result of its past

[13] *Id.*

[14] *Policy and Rules Concerning Rates for Dominant Carriers*, Order on Reconsideration, CC Docket No. 87-313 ¶102 (1991).

productivity performance.[15] Consequently, it was entirely reasonable for price cap LECs to conclude that add back was not an integral part of the price cap sharing mechanism because it would further diminish the efficiency incentives envisioned by price-cap regulation by reducing the retained rewards of efficiency improvements.

Third, calculating total earnings in a period, without add back, would not necessarily result in "see-saw" variations in earnings, which was a concern articulated by the Commission in the *Add-Back NPRM*. In fact, extending the Commission's example of add back set forth in the *Add-Back NPRM* an additional two years clearly showed that the effect of excluding add back revenues stabilized.[16] Also, based on the split tariff/sharing year situation faced by many price cap LECs, sharing variations year over year were even smaller and subsided more quickly, which could have lead many LECs to conclude that add back was unnecessary.[17]

Fourth, as the prior record in this proceeding demonstrates, in certain instances add back could result in sharing well beyond the one-year period.[18] Thus, it was understandable for price

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[15] Other differences between sharing and refunds are as follows: (1) refunds result from rate-of-return, cost-plus regulation, while sharing results from incentive regulation; (2) refunds exclude earnings from interexchange services, while sharing includes earnings from the interexchange basket; and (3) the amount refunded is unaffected by future demand, while the total amount shared is affected by future demand.

[16] *See* Ameritech Comments at 4, Exhibit 1. (Aug. 2, 1993)

[17] *Id.*, Exhibit 2.

[18] *See* Ameritech Comments at 6. (Consider a simple example in which a LEC (choosing a 3.3% total offset) earns above 12.25% in year one. Assume also that the LEC would earn just under 12.25% without add back for the second and subsequent years. With an add back, the sharing amount caused by the earnings in year one would throw the LEC into sharing due to year two's earnings (year two's actual earnings plus year one's add back). This add back originally caused by earnings in year one would also push year three's and subsequent years' actual earnings into sharing levels as well. Thus, the add back for just one year's sharing amount could affect an indefinite number of year's rates — something clearly not intended by the Commission's price cap order.).

cap LECs to conclude that following the add-back rules could conflict with the Commission's express findings that sharing is a "one-time reduction in the PCI for the next rate period."[19]

It thus was entirely reasonable that some price cap LECs would have calculated their sharing obligations for 1993 and 1994 based on their actual 1992 earnings, while others would have followed the add-back rules governing rate-of-return carriers. Consequently, the Commission should conclude that either approach was reasonable under the Commission's pre-1995 price-cap rules.

2. Would application of the add-back rule to the 1993 and 1994 access tariffs constitute unlawful retroactive application of a substantive rule change?

It is well-settled under federal jurisprudence that federal agencies lack authority to apply substantive rule changes retroactively unless expressly permitted to do so by Congress.[20] Thus, the first question that must be resolved here is whether adoption of the add-back requirement for price cap LECs constituted a substantive rule change. Unquestionably the answer is yes. As the Commission expressly stated in its *Add-Back NPRM*, its then-existing price-cap rules and orders neither addressed nor required price cap LECs to follow the add-back rules governing rate-of-return carriers. Consequently, the Commission *tentatively* proposed to adopt the requirement and ultimately revised its rules to require price cap LECs to add back in 1995. Because the pre-1995 price-cap rules did not require price cap LECs to add back, adoption of the add-back requirement in 1995 constituted a substantive rule change.

[19] *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6803 (1990).

[20] *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 109 S.Ct 468, 102 L.Ed.2d 493 (1998) ("a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.)

The next inquiry is whether applying the add-back rule to the 1993 and 1994 access tariffs would constitute unlawful retroactive application of the rule. In determining whether a rule operates retroactively, the courts have considered whether application of the rule "impairs rights a party possessed when he acted, increases a party's liability for past conduct, or imposes new duties with respect to transactions already completed."[21] While satisfaction of each of these factors is not required, each are met here.

First, applying the 1995 add-back rule to the 1993-1994 period would not only impair the right of price cap LECs to exclude their sharing or low-end adjustment from their rate of return calculations, it would obliterate this right — a right price cap LECs clearly had under the pre-1995 price-cap rules. Second, application of the rule necessarily would result in a finding of liability for any price cap LEC that did not add back. Third, application of the rule would require price cap LECs that did not add back to recalculate their sharing obligations for prior years and issue a refund. Such effects would completely "change the legal landscape" for the affected price cap LECs, "creat[ing] a new obligation, impos[ing] a new duty, and attach[ing] a new disability in respect to transactions or considerations already past."[22] Application of the add-back rule, accordingly, would constitute retroactive administration of the rule.

The remaining inquiry is whether Congress expressly permitted the Commission to retroactively apply substantive rule changes. Section 4(i) of the Communications Act of 1934, as amended, certainly gives the FCC broad authority to make rules and regulations consistent with the Act,[23] but it does *not* authorize the agency to apply such rules retroactively. Without explicit

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[21] *Landgraf v. USI Film Products et al.*, 511 U.S. 244, 280 (1994).

[22] *Nat'l Mining Ass'n v. United States Dep't of Interior,* 177 F.3d 1, 8 (D.C. Cir. 1999) (quoting *Ass'n of Accredited Cosmetology Sch. V. Alexander*, 979 F.2d 859, 864 (D.C. Cir. 1992).

[23] 47 U.S.C. § 4(i).

authority to do so, the Commission can only apply substantive rule changes, such as the add-back rule *prospectively*. That is not to say that the Commission is without authority to conclude that it was reasonable for price cap LECs prior to 1995 to follow the add-back rules. However, the Commission cannot determine that price cap LECs were obligated to do so. Consequently, a price cap LEC's failure to add back its sharing or low-end adjustment to compute its 1992 rate of return cannot be the basis for rejecting its 1993 or 1994 annual access tariff.

III. CONCLUSION

For the foregoing reasons, the Commission should conclude that any price cap LEC's failure to add back in computing its 1993 and 1994 sharing obligations was not an unjust or unreasonable practice under the Commission's pre-1995 price-cap rules.

Respectfully Submitted,

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